Amherst Capital Management

Transforming real estate investing with data, analytics and innovative technology

Recently, **Jonathan A. Schein**, managing director of global business development at Institutional Real Estate, Inc., spoke with **Sean Dobson,** chief executive officer and chief investment officer of Amherst Capital Management LLC (Amherst Capital). Sean also serves as chair and chief executive officer of Amherst Holdings (Amherst). The following is an excerpt of that conversation.

Sean Dobson
Chief Executive Officer and Chief Investment Officer of Amherst Capital Management.

With more than 25 years of experience analyzing, pricing, originating, servicing and managing a broad range of real estate related risks, Sean is widely recognized as one of the leading strategists in the industry and an expert in all facets of the mortgage markets and their related derivatives.

Sean currently serves as a governing trustee for the Dana-Farber Cancer Institute, and is co-founder of CapCityKids.

You started off in investment banking focused on the credit markets. Why the move into asset management?

It was the natural progression for what we had already started. In my opinion, the investment bank Amherst Holdings ran separated itself from the pack by providing clients with a comprehensive solution that included investment research and trading strategies that leveraged Amherst Holdings' unique data and analytics platform, and over the years that led further and further into the investment management process. Part of the decision was driven by where the U.S. economy is in its recovery from the financial crisis.

How so?

During the financial crisis, I believe Amherst Holdings was one of the first to pursue an activist strategy related to securitizations, where we actually took control of distressed securitizations, then represented the investors in recovering on their investments. Our experience led us to believe that the securitization market is broken — that there are too many people between the borrower and the lender. This process is inefficient, expensive, lacks transparency and accountability — we knew there was a better way to get things done, and that's what we've set up with Amherst Capital.

What has been your solution to a "broken" securitization market?

Our answer was to build a completely vertically-integrated asset management platform, where we act as fiduciary to the investors, and where we have all the capabilities internally to originate and loans, as well as develop investment strategies supporting those loans, and represent the investors throughout the lifecycle of the loan transaction. Every capability is under one roof. We are structuring a loan agreement with the borrower that we believe the borrower will be successful in repaying. You could argue that it is the new way of getting back to the old way!

Amherst Holdings has partnered with both the Bank of New York Mellon Corporation (BNYM), and the Texas Treasury Safekeeping Trust Company (Texas Trust).[1] How does that work?

Amherst Capital is majority-owned indirectly by BNYM and minority-owned by Amherst Holdings. As a founding seed investor, Texas Trust is expected to benefit as the platform grows. Collectively, BNYM and Texas Trust committed a substantial amount of seed capital to get our platform off the ground.

Why did you choose to partner with BNYM?

BNYM has a global asset management infrastructure, has been in the business for a very long time, understands the regulatory landscape and the type of infrastructure that a world-class institutional asset manager is expected to provide. Their global reach also provides an entrée to the world's investors.

And what about Texas Trust?

Texas Trust has been a long-time partner of Amherst Holdings. They have helped us understand the needs of institutional investors, and given us strategic advice on how to develop a set of services and products that would appeal to investors. We wanted to ensure our platform would be fully institutional-grade from a compliance and internal controls perspective, as well as from a reporting perspective.

What do you mean by "full quantitative analytic capability"?

Risk-pricing analytics has been our strong suit for a long time. Amherst Holdings has its own super computer, and we've continually invested millions of dollars into developing our technology over the past 20 years — we rarely see any other real estate firm with the same staffing in terms of mathematicians, data scientists and "quants" that we do. There's a pretty big gap between the leading edge of analytics in the equity and fixed-income derivative markets and where analytics are for real estate in the private markets.

Can models really predict the future?

There is a great saying about models — all models are wrong and some are useful. If you ask 100 financiers about a price for a put option on a stock, 100 people will give you the same answer. If you ask 100 people about how to price a commercial real estate loan, you might get 99 different answers. We not only think it should be the same answer, but we think it is the same answer as the stock question: You need to figure out how to price the put option you sold the borrower on that building. When we talk about models, we are talking about a reliable distribution of outcomes at the property level that allows us to price the various components of the capital structure. The models won't tell you the future, but they are able to give you a high confidence interval of what the range could be. From that you can develop distinct strategies.

Do you have to know the real estate in order to lend?

I believe you need a one-standard-deviation of accuracy for the earnings potential of that building. A lot of people spend time driving around looking at the building — and we do this, too — but that type of fundamental research only gets you so far. Amherst Holdings' proprietary technology blends rich asset-level detail, quantitative capabilities and strong fundamental insights that provide a unique view into the fundamentals driving asset performance.

How so?

When Amherst Capital lends on a building, we are in essence giving the borrower the right to send us the key if things don't work out. In the risk-pricing process, if we lend somebody $50 on the building, we need to understand the probability of the building being worth less than $50 during the term of our loan. That is how we need to go about pricing our credit. We don't hear a lot of people having that conversation. We hear people saying 65 percent loan-to-value (LTV) is good, but 75 percent LTV is bad. Saying, "Manhattan is great, Los Angeles is excellent, but Dallas is terrible." But you can find exceptions within the market for all of those beliefs. It is our business to understand the risks we are actually buying over a longer period of time — the expected return for that asset and how it compares to all the other real estate in the country and all the other investments in the world, and then adjust our investment strategy. With our data and analytics platform, we are able to answer those types of questions.

How do you go about deciding which asset works for you?

On the private side, Amherst Capital has two distinct strategies: we have a single-family equity strategy, where we are buying large portfolios of single-family homes, and we have a commercial debt strategy, which originates senior loans on transitional real estate assets. We think that the commercial real estate equity markets are getting to the point where their risk outweighs their return. Therefore, on the commercial real estate side, we went up the capital structure to the senior debt market. We have lent on industrial logistics, manufacturing, hospitality, high-street retail. We don't get too amped up by the fact that these things have a different use. They are long-term, fixed assets that are getting one-year, five-year or 10-year agreements for occupancy. It really is the question of, over the long term, what are the drivers of the risk in that asset?

Is real estate pricing still solid?

There are approximately 30 million pieces of commercial real estate in Amherst Holding's real estate database, and 85 million single-family homes, so you have to think about it very specifically. There are definitely pockets of value, but we are discouraging people from adding gateway city trophy assets, because at the current multiples for those assets, there are many different financial assets that we believe may produce either the same return with a lower risk or a higher return with the same risk. That being said, I was recently in Beijing talking to some investors who were buying gateway city properties, and they pointed out to us that they were selling properties in China at a capitalization rate that was about half of what they were buying in Manhattan. This whole question of, "Is it a bubble?" is really a question of, "Is there some temporary stimulus driving pricing that will evaporate, causing the price to reset lower?" Today that stimulus in those trophy properties is foreign capital flows into U.S. dollars, and we don't see a lot of other places that capital can go in the near term. We think that stimulus is not going to dry up overnight, causing a bubble to burst.

Have we learned any lessons from the Great Financial Crisis (GFC)?

That remains to be seen — I believe a lot of the same mistakes are still being made. We should learn a lesson that you can't put complicated investments into a brain-dead trust and expect that they are going to work out for everyone. I also think we have learned that property investing should not be thought of as a risk-free business. See what has happened to retail. The whole dynamic around the customer base has changed dramatically in a very short period of time. We think people should bring a sharper eye to the risk analytics of property investing and not understate what can happen as cycles shift.

It also seems to me that in the GFC, real estate just got too complicated. It became financial instruments as opposed to real estate.

I couldn't agree more. There is so much complexity at the asset level, and you've got to consider: How durable is the asset? What is driving demand for the current use case? Where is this piece of real estate situated in its local market? How is this local market competing with the broader market? How is the U.S. competing with the global markets? There is enough complexity in that, so you don't need to have 25 classes of interest in a loan.

A last word?

The real estate markets of today and tomorrow need a vertically-integrated and aligned approach — they just require it. In almost every other industry you can get incredibly specific with particular data points, market segments or historical trends, while real estate has been behind the data curve for too long. These capabilities do exist — Amherst can drill down to the individual property level in specific MSAs and compile a quantitative analysis. With the support of our partners and differentiated analytical insights, we believe Amherst Capital is well-positioned to react nimbly and with scale to the evolving opportunities in the post-crisis real estate capital markets.

CORPORATE OVERVIEW

Amherst Capital is a U.S. real estate investment specialist with $6.1 billion[2] AUM. It offers a suite of traditional and alternative real estate strategies that span the risk-return spectrum.

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This article presents the author's present opinions reflecting current market conditions. It has been written for informational and educational purposes only and should not be considered as investment advice or as a recommendation of any particular security, strategy or investment product.

[1]It is not known whether the listed client approves or disapproves of the adviser or the advisory services provided. Amherst Holdings is not an affiliate of BNY Mellon.

[2]As of September 30, 2017. This amount includes $4.4 billion assets pertaining to certain discretionary multi -sector fixed income clients of our affiliate Standish Mellon Asset Management Company, LLC ("Standish"), for which certain Amherst Capital employees provide advice acting as dual officers of Standish. In addition, discretionary portfolios with approximately $386 million are managed by certain of our employees in their capacity as dual officers of The Dreyfus Corporation. AUM includes gross assets managed in the single family equity and commercial real estate strategies, which include $244 million and $28 million of leverage, respectively.